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DECODING PRIVATE MARKETS

GOOD THINGS COME TO THOSE WHO DON'T WAIT

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Duration is the engine of private market returns, but for open-ended evergreen funds, it can create a structural liquidity problem. Secondaries compress that duration, turning the promise of liquidity into more predictable tools for recycling and compounding.

Duration makes up a significant source of returns for private markets investments. The long-dated horizons of these asset classes are the engine of compounding and the driver of the illiquidity premium, allowing patient capital to ride out volatility rather than being forced into a sale. This is true across all private market asset classes, including private equity, private credit, and infrastructure.

But while duration is an attractive feature for closed-end investors with a defined horizon, it can create a fundamental structural tension inside an open-ended evergreen vehicle that promises periodic liquidity. An evergreen fund must be able to meet redemptions, support NAV stability, and recycle capital into new opportunities, none of which are well served by assets whose cash flows are heavily back-ended and whose hold periods extend far beyond a fund's liquidity windows.

The result for some evergreen funds may be a portfolio that can appear liquid on the surface while being functionally illiquid underneath – reliant on new investor inflows rather than portfolio cash flows to meet redemption requests or provide deployment budget.

This is not a theoretical risk. It is the defining structural vulnerability of any evergreen vehicle that takes on excessive long-duration primary exposure without a counterbalancing liquidity mechanism.

The secondary solution

Secondaries may offer a direct and elegant solution: by acquiring existing stakes in existing funds or assets, secondary investors step into the lifecycle of the asset at a materially later stage and provide the seller with much-needed liquidity.

For asset classes like infrastructure or real estate, secondaries investors can access assets that are already built, operating, and generating cash-flows, and where the development phase (typically the most capital-intensive, illiquid, and uncertain period) has already been absorbed by the original investor.

The visibility into the underlying portfolio being acquired is also true for private equity and private credit secondaries. This provides the buyer with the ability to re-underwrite each investment in the portfolio which can be anywhere from two to five years into their investment period and that much closer to realisation.

This single structural difference compresses duration dramatically. Where primary infrastructure investments, for example, might require an eight- to 20-year hold, secondaries typically deliver returns over a four- to six-year horizon.

Duration compression in practice

For an evergreen vehicle, the duration compression offered by the secondaries markets can have real implications for evergreen funds.

Liquidity as a feature not just a label

The most immediate consequence of shorter duration is improved liquidity, and in an evergreen context, this provision is critical. If underlying assets begin generating distributions sooner, the fund has genuine internal liquidity to draw on when meeting redemption requests, rather than being forced to rely on new subscriptions or gating mechanisms.

This is the difference between a fund that is structurally liquid and one that is merely marketed as liquid.

Secondaries funds, with their earlier and more predictable cash flow profiles, are one of the most effective tools available to evergreen managers seeking to make the liquidity promise a reality.

Capital recycling: the compounding engine

Shorter durations not only improve liquidity but also power the capital recycling engine that drives an evergreen fund's compounding potential over time. When distributions from secondaries flow back into the fund earlier, that capital can be redeployed into new investments, maintaining portfolio freshness, improving diversification, and supporting consistent NAV growth.

For an asset class like infrastructure, where the duration of the asset class is naturally-long dated and can be back-ended, secondaries can help to change that duration profile and provide flexibility to an evergreen fund.

Reducing dependence on new investor inflows

A fund that cannot generate its own internal liquidity is dependent on a continuous stream of new subscriptions to fund new investments or redemptions. This is a fragile and potentially self-reinforcing vulnerability. In periods of market stress or reduced investor appetite, this dependence can become acute, forcing managers to gate redemptions, sell assets at unfavourable prices, constrain new investment activity or even use leverage to address the liquidity need of the fund.

By generating earlier and more predictable distributions, secondaries funds can reduce this dependence materially, making the fund more resilient across market cycles and more credible in its liquidity promises to investors.

Trimming the J-curve drag

In secondaries investments, capital is immediately put to work. This is particularly important in asset classes like infrastructure, where secondaries can give investors access to assets that are already income-generating and operationally proven, avoiding the multi-year period of fee drag and limited value realisation that characterises primary commitments.

In a vehicle that charges management fees on invested capital, eliminating the J-curve may also be a meaningful net return benefit.

Why it matters to you

Duration shouldn't deter any investor from exploring the benefits of private markets. When these asset classes are fully understood and accessed via secondaries, duration can become a real advantage and underpin real – not just promised – liquidity.

IMPORTANT DISCLOSURE

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